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In the

Supreme Court of the United States

OCTOBER TERM, 1958

No. 701

GENE CLUCK AND VIVIAN CLUCK,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,
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To the Honorable Earl Warren, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioners respectfully show:

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 12-27) are reported at 29 T. C. 7.

The decision of the United States Court of Appeals for the Fifth Circuit is reported at F. 2d .

JURISDICTIONAL STATEMENT

The judgment sought to be reviewed is the judgment of the United States Court of Appeals for the Fifth Circuit. Said judgment was rendered on the 19th day of November, 1958 (R. 51). The judgment of the Court of Appeals for the Fifth Circuit affirmed a decision of the Tax Court on a matter involving the taxation of income within the meaning of the Revenue Act of 1938 as amended (Internal Revenue Code, Section 122) (R. 51).

The jurisdiction of this Court is invoked under Section 140A of the Judicial Code as amended *(28 USCA Section 347)*.

It is urged that this Court exercise its discretion to review because of the importance of the question involved in the administration and interpretation of the Revenue laws and because of conflict in principle of the decision below with that of decisions by this Court and by other Courts of Appeal.

The jurisdiction of this Court to review, by Certiorari, a judgment of a court of appeals on the grounds urged was sustained in *Helvering v. Horst, 311 U. S. 112, 61 S. Ct. 144.*

QUESTIONS PRESENTED

1. Will a loss sustained on the sale of cattle originally purchased as a breeding herd qualify as a "net operating loss" deduction to a rancher who discontinues the use of a breeding herd but continues in the cattle ranching business?

2. Will a loss sustained by a rancher on the sale of cows purchased as a breeding herd but sold as property held primarily for sale to customers in the ordinary course of business qualify as a net operating loss?

3. After the prolonged discontinuance of the use of cows as a breeding herd, is it possible under the law for such animals to be converted to property held primarily for sale to customers in the ordinary course of business and losses sustained thereon allowed as net operating losses?

STATUTES INVOLVED

(26 U. S. C. 1952 Ed.)

SEC. 122. [Added by Sec. 211(b) of the Revenue Act of 1939, supra.] NET OPERATING DEDUCTION.

(a) [As amended by Sec. 105(e) of the Revenue Act of 1942, c. 619, 56 Stat. 798.] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 215(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906.] *Amount of Carry-Back and Carry-Over:*

(1) *Net operating loss carry-back.*—

* * *

(B) Loss for Taxable Year Beginning After 1949. If for any taxable year beginning after December 31, 1949, the taxpayer has a net operat-

ing loss, such net operating loss carry-back for the preceding taxable year.

* * *

(d) [As amended by Sec. 105 (e) (3) (C) of the Revenue Act of 1942, supra.] *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

* * *

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions, additions, and limitations specified in paragraphs (1) to (4) of this subsection.

* * *

(26 U. S. C. 1952 ed., Sec. 122.)

SUMMARY STATEMENT OF THE MATTER INVOLVED

The petitioners, husband and wife, were in the farming and ranching business. Throughout the years 1951 and 1952, they owned a commercial cattle herd. (R. 13, 34, 15, 36. Schedule 2, Stipulation of Facts.)

During the year 1951, petitioners acquired a breeding herd of 288 cows, which herd was on hand on January 1, 1952. (R. 14, 35, Schedule 1, Stipulation of Facts.) On February 16, 1952, Bangs disease was discovered in the

breeding herd of petitioners and thereupon petitioners discontinued the use of their cows as a breeding herd (R. 14, 38). On February 16, 1952, the cows were thin and petitioners decided to keep the cows, fatten them up and sell them as commercial cattle (R. 14, 38). At this time petitioners determined that these cows were no longer a breeding herd (R. 42, 21).

With the exception of three cows, petitioners held said cows from February, 1952 until October, 1952, when 176 were sold, 64 were sold in November, 1952, 6 in December, 1952, and the balance were carried over to 1953. (R. 35, Schedule 1; Stipulation of Facts.) The subject cows were sold at the same time or in the same months as petitioners sold other commercial cattle. (R. 36, Schedule 3, Stipulation of Facts.)

In selling the subject cows in 1952, petitioners sustained a net loss of $15,776.13. (R. 15, Exhibit B, Schedule 1, Stipulation of Facts.)

The petitioners seek to have said loss treated as a net operating loss to be carried back and applied against their taxable income for the calendar year 1951.

The Commissioner determined that the loss on the [illegible] of the cows was a loss from the sale of an asset [illegible] trade or business and that such a loss on a sale [illegible] used in a trade or business did not qualify as a net operating loss (R. 10). The majority opinion of the Tax [illegible]

held that the loss sustained was not a loss "attributable to the operation of a trade or business regularly carried on" because the breeding herd was liquidated (R. 12-20).

The Court of Appeals for the Fifth Circuit affirmed by per curiam opinion (R. 49-50).

REASONS RELIED ON FOR ALLOWANCE OF WRIT

I.

Section 122 of the Internal Revenue Code permits a taxpayer to carry to a prior year a net operating loss. A net operating loss is defined as the excess of the deductions allowed over gross income, however, deductions which are not attributable to the operation of a trade or business regularly carried on by the taxpayer are allowed only to the extent of the gross income not derived from such trade or business.

In the instant case, a rancher who was engaged in the cattle business, and who had a commercial herd as well as a breeding herd, was forced by circumstance to discontinue the use of cows as breeding animals; however, he continued in the cattle business without the use of a breeding herd. After discontinuing the use of his cows as breeding animals, the rancher retained the animals eight or more months, fattened them and finally sold them as animals held for sale to customers in the ordinary course of business.

This case involves that part of Section 122 which excludes from a net operating loss, deduction not attributable to the operation of taxpayers regular business. The case is

unique in that plaintiffs loss was from the sale of property which was identical with their stock in trade and it further has an unusual characteristic in that plaintiffs spent a number of months putting the subject property in a form and condition whereby it would measure up to the standards plaintiffs required of the property which they held for sale to customers in the ordinary course of business. The Tax Court and Court of Appeals took the position that since the subject cattle were purchased as property for use in the trade or business, they were not deprived of that character at date of sale, and then it was reasoned that losses on the sale of property used in a trade or business could not qualify for a net operating loss if the plaintiffs discontinued the phase of business in which said property had been used.

It would appear that by this process of reasoning, as applied to the facts and circumstances of this case, the relatively simple provisions of Section 122 have become unduly restricted and peculiarly distorted.

The decision in the subject case places a high premium and the entire emphasis on whether or not a particular sale was in any way related (remote or proximate) to a discontinuance of some operational phase of a business.

The test of the statute is whether or not the subject loss was an incident to the operation of a trade or business.

It is believed that the Courts below have let a single incidental factor (which is properly to be used only as an aid) become the controlling guide in making the determi-

nation of the ultimate question of whether or not the loss was from the operation of a trade or business.

There are other factors to be considered, all of which were ignored by the Courts below. For instance, the Courts should have considered:

1. Plaintiffs principal trade or business immediately prior to the subject sale.

2. Plaintiffs principal trade or business immediately following the subject sale.

3. The use for which the subject cattle were sold.

4. The appropriateness of the subject cattle for said use.

5. The nature of plaintiffs stock in trade.

6. The difference, if any, of plaintiffs stock in trade and the property sold.

7. The time elapsing since the subject property was used for breeding purposes.

8. The time elapsing since the breeding herd was discontinued.

9. Any other factors appropriate under the circumstances in determining whether the loss sustained was the proximate result of the operation of a trade or business regularly carried on by the taxpayer.

In the decision of tax cases there may be a tendency to attempt the solution of difficult tax problems by the use of a simple, easy to apply, and often inadequate rule or legal standard. It is felt that in the instant case a difficult problem has been presented and that it has not received the consideration required for its proper disposition. The plaintiffs hold the conviction that a proper consideration of this

case by the use of proper legal standards would result in a reversal of the Courts below.

So far as has been determined, this Court has not had occasion to consider the statute here under consideration. In *Dalton v. Bowers, 287 U. S. 404, 53 S. Ct. 205*, this Court did consider whether or not a loss sustained on stock becoming worthless was a loss sustained in the operation of the taxpayer stockholder's trade or business. In considering the question presented, this Court gave due consideration to all the matters of fact there involved and thereby indicated the inadequacy of a mechanical rule of thumb which looks to only one external factor in making the finding of fact as to whether or not a particular loss was sustained in the operation of a trade or business.

The decision in the instant case is in conflict with what is believed to be the principles of law set out in the decision of the Supreme Court in *Dalton v. Bowers*, supra; see also *Snyder v. Commissioner, 295 U. S. 134, 55 S. Ct. 737;* and this Court should review the decision herein rendered to the end that such conflict may be resolved.

II.

To be deductible, the expenses of a corporation must have been incurred in "carrying on a trade or business"; in the case of individuals, losses "not attributable to the operation of a trade or business regularly carried on by taxpayer" will not qualify for a net operating loss carryback.

In the case of bad debts, a "non-business debt" is defined as a "debt other than (a) a debt created or acquired (as

the case may be) in connection with a taxpayers trade or business; or (b) a debt the loss from the worthlessness of which is incurred in the taxpayers business."

The phrases

"incurred in carrying on a trade or business",

"attributable to the operation of a trade or business",

"created or acquired in connection with a taxpayer's trade or business",

"incurred in the taxpayer's trade or business",

are of importance in the administration of the Federal tax law. A confusing array of decisions is being built up in the areas where a transaction receives a particular tax treatment if it is incurred in, attributable to, or created or acquired in a taxpayer's trade or business. *Federal Income Gift and Estate Taxation, Rabkin & Johnson §35.01(3), §35.08(4); Law of Federal Income Taxation, Merten's Volume 5, §29.05, pages 372-373.* The meaning of the foregoing phrases should be settled by the Supreme Court.

This case presents to this Court an appropriate case whereby the question of whether or not the subject loss was incurred in carrying on a trade or business is squarely at issue. The facts in the subject case present the questions in such manner as to emphasize all of the implications of the answers which might be given.

And further, the instant case, while unusual in many of its factual aspects, presents a number of intensely practical problems which every day are encountered by men in business.

The clarification by this Honorable Court of the points raised by this proceeding will be of inestimable value to men of business in this nation.

III.

The decisions of the Tax Court and Court of Appeals herein infer that if an asset is acquired for use in a trade or business, the sale of said asset cannot be an incident to a taxpayer's trade or business unless said asset is immediately replaced with an asset similar in use and kind. The implication of such a decision is that

(1) An asset used in a trade or business cannot change its character and become part of a taxpayer's stock in trade or inventory.

(2) The sale of an asset used in a trade or business can be an incident to taxpayers trade or business only if the asset sold is replaced or only if similar properties are retained.

On the points of inference as here noted, it appears that the decision of the Court of Appeals and the Tax Court is in conflict with those cases wherein the Courts of Appeals have held that assets acquired for use in a trade or business may be converted to assets held primarily for sale to customers in the ordinary course of their business and the disposition thereof is a part of a taxpayer's business though he does not replace same. *The Home Company, Inc. v. Commissioner of Internal Revenue (10th Circuit), 212 F. 2d 637; John P. Dougherty v. Commissioner (6th Circuit), 216 F. 2d 110.*

To settle the apparent conflict between the decision of the Court of Appeals for the Fifth Circuit in the instant case

and the decisions of the Court of Appeals as Tenth and Sixth Circuits as herein noted, it is submitted that this Court should review the decision herein rendered by the Court of Appeals for the Fifth Circuit.

CONCLUSION

WHEREFORE, your petitioners pray that a Writ of Certiorari issue under the seal of this Court, directed to the United States Court of Appeals for the Fifth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Circuit Court had in the case numbered and entitled on its docket No. 17,122, *Gene Cluck and Vivian Cluck, Petitioners v. Commissioner of Internal Revenue, Respondent*, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Court of Appeals be reversed by the Court and for such further relief as to this Court may seem proper.

Respectfully submitted,

Original signed by:
ARTHUR GLOVER

ARTHUR GLOVER,
1608 Polk Street,
Amarillo, Texas,
Attorney for Petitioners.

APPENDIX

In the

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 17122

GENE CLUCK AND VIVIAN CLUCK,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of Decision of the Tax Court of the United States (District of Texas).

(November 19, 1958)

Before TUTTLE, JONES and BROWN, Circuit Judges.

PER CURIAM: This case, in its essential facts, brings taxpayers and Commissioner into a contest in which each of them takes a position exactly opposite to that assumed by the taxpayer and Commissioner in *Carter v. Commissioner of Internal Revenue*, 5 Cir., 255 F. 2d 595. Having decided that on such similar facts the sale of the breeding herd in Carter was the sale of Section 1175 asset, we also hold here that the sale of the breeding herd at a loss did not produce a loss "attributable to the operation of a trade or business

regularly carried on by the taxpayer" within the terms of the loss carry-back provisions of the Internal Revenue Code of 1939.

The decision of the Tax Court is AFFIRMED on the opinion of the Tax Court, 29 T. C. 7, and on the authority of *Carter v. Commissioner, supra.*

A true copy

Test: s/Edward W. Wadsworth
EDWARD W. WADSWORTH

Clerk, U. S. Court of Appeals, Fifth Circuit
New Orleans, Louisiana

(Seal)

JUDGMENT

Extract from the Minutes of November 19, 1958

No. 17122

GENE CLUCK AND VIVIAN CLUCK,

v.

COMMISSIONER OF INTERNAL REVENUE.

This cause came on to be heard on the petition of Gene Cluck and Vivian Cluck for review of a decision of the Tax Court of the United States, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the decision of the Tax Court in this cause be, and the same is hereby, affirmed.

* * * * * *